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The New Enterprise Law

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January 1, 1988, the Soviet Union began implementing the radical economic reform about which Mikhail Gorbachev has talked so much. At its heart is the new "Law of the USSR on the State Enterprise (Association)" [LSE], complex legislation designed to break with Stalinist economic practice and make Soviet enterprises into autonomous, democratic, financially independent producers. The Law is explained in a visionary document, "Basic Provisions for the Radical Restructuring of Economic Management," approved by the June (1987) Plenum. It is further elaborated in a set of decrees jointly promulgated on July 17, 1987, by the Party and government.[1] Bold in vision and promise, the Law also contains great gaps and contradictions.

Under the new legislation Soviet producers are to cease being cogs in an administrative hierarchy — merely following instructions and dutifully reporting activities and results. They are to become efficient, autonomous, entrepreneurial, and fully self-supporting firms. At the same time, however, they are expected to fulfill the norms and goals of society as outlined by the central organs of the Party and the state. In particular, they bear responsibility for accelerating technological progress, raising the quality of output, and rebuilding the industrial structure. They are to support social infrastructure and provide desired goods and services at the right time in the right quantities and at prices reflecting the true values of these commodities to society. Finally, they must fully satisfy the material, social, and "spiritual" needs of their employees, and discover and exploit (with appropriate approval) new opportunities for the expansion of material wealth and the satisfaction of the Soviet people.[2] What is the logic of the Law by which all this is to be accomplished, and what does the Law imply for, and require of, the Soviet economic system?

The Structure and Logic of the Law

The Law on the State Enterprise consists of 25 articles gathered into three groups. The first group [Articles 1 through 4] identifies the enterprise as the basic unit of the economic system, outlines its rights, responsibilities, principles of operation, and the nature of its income, and provides a general overview of the Law. Articles 5 through 9 deal with issues of management and self-management, defining the nature of democratization of the enterprise so prominent in the rhetoric of *perestroika.* They spell out the key principle of self-management by the Labor Collective through its Council and the election of directors and others. And they describe the internal organizational structures allowed to the firm as well as the nature of a firm's independence from central organs such as its ministry, the State Planning Committee (GOSPLAN), and the State Bank (GOSBANK).

The last group of articles, from 10 through 25, addresses the issues of greatest economic significance for the Law's realization: planning, financing, investment, supply, sales and trade, labor and wages, accountability and control, and the creation and elimination of enterprises. Here is where the concept of planning from below receives definition as based on commercial orders (*zakazy*), wholesale trade, self-financing, negotiated prices, and self determination in the use and distribution of earned incomes. It is in implementing the provisions of this section that the greatest difficulties are apt to arise.

1 The Law appeared in *Pravda*, July 1, 1987, and CDSP, #30, 31, 1987. The Basic Provisions appeared in *Pravda*, June 27, 1987. The supporting decrees were published in *On Radical Restructuring of Management of the Economy*, Moscow: Politizdat, 1987.
2 See in particular Articles 1, 10, 11, 12, 13 and 20.

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As stated in Article 1, enterprises are granted public property in order to increase its value, and to do so in the pursuit of central objectives and the fulfillment of the national economic plan. That plan, in turn, is now supposed to reflect better the requirements of the economy and society by being built from the bottom up. Enterprises will draw up their own plans on the basis of general central guidelines or control figures and commercial orders from both the State and other users. The enterprise is to be on its own financially, with earnings dependent on goods and services sold. No longer will it be guaranteed a planned outlet for its product. Earnings are to provide a constraint as well as an incentive, for they must cover all the costs of the firm, including wages, taxes, investment, and materials purchases. They can be temporarily enhanced through borrowing, particularly for purposes of investment, and are protected by law from confiscation by superior organs [Articles 9, 4, 2, and 17.3]. There are provisions for enterprises in financial difficulty to receive temporary financial assistance from above. There are also insolvency procedures, up to bankruptcy and dissolution, for those enterprises unable to return to profitable operation [Articles 16 and 18]. Thus the enterprise has gained both enhanced responsibility and increased independence, including the right to fail.

This is a dramatic departure from the existing system, where the financial implications of any economic activity are of decidedly secondary importance. Enterprises are judged, instead, by how well they meet numerous, largely physical plan targets, such as production levels, input use, and product assortment. Indeed, financial constraints are not allowed to disrupt real economic activity. Financial resources are always provided for planned activities, and above plan earnings are confiscated into the State budget. Because losses are subsidized and profits confiscated, the level of earnings has little meaning for the present Soviet producer. Now, however, earnings are to become the decisive consideration.

Yet, for the firm to make proper, efficient use of its new autonomy, it must find itself in a radically restructured economic environment. First, it needs to have a clear idea of general social objectives, of the kinds of products and processes that planners want to see developed, without finding itself limited to specific patterns of economic activity. For example, the socially desirable structure of investment and the resulting structure of capital and technology needs to be communicated without forcing specific choices on the firm. This implies a dramatic change in the nature of planning, as indeed the Law calls for [Article 10]. Plans are to be much more conceptual and strategic, laying out the broad lines of development over the course of a 15 year period and, in greater detail, the tasks and objectives for the first five years. The latter will become the primary operational document, the five-year "State Plan for Economic and Social Development," whose purpose is to inform and guide enterprises as they formulate their own five-year and annual plans, and not to command them.

Central plans are to contain only four types of guiding instruments through which to ensure that enterprises efficiently pursue the objectives of the central authorities [Articles 1, 2, and 10]. The first type, general guidelines called control figures (*kontrol'nye tsifry*), defines the basic objectives of economic activity, including desired levels of production and efficiency criteria and targets. The next type of guidance most reflects past practice. It consists of specific commands from the central authorities, called state orders (*goszakazy*), for production, investment, and allocation in many of the economy's most important sectors. So, too, are there ceilings (*limity*) on specific kinds of investments and materials allocations. Both are elaborated annually by ministries on the basis of five year aggregate targets, and material and other balances. Finally, the new Law establishes a whole host of "guiding" coefficients, called economic normatives (*ekonomicheskie normativy*), designed to regulate the allocation of an enterprise's income to payments for land, labor, and capital, state and local taxes, wage-incentive programs, and investment in child-care, recreational, and housing facilities as well as plant and equipment. These four forms of guidance are to substitute for one-year operational planning by the State Planning Committee (GOSPLAN), the ministries, and other central organs. Producers are now to draw up their own operational plans on the basis of these four sets of parameters.

Gorbachev and his economists hope that planning at the enterprise level will guarantee economic decisions that are more highly motivated and based on more accurate local information. In this they want firms not only to take advantage of knowledge on the ground, but also to exercise initiative in ways that the bureaucracy never could. Firms will have to gauge current and future demand in order to plan "properly," and meet their general targets. Most of this demand should come from other enterprises, cooperatives and individuals, although the state, too, will be able to purchase from them (and on a priority basis). Although control figures provide guidelines on which to base estimates, firms will also have to act on information derived from orders based on negotiated contracts and long term direct economic ties with users. They, in turn, will have to arrange contracts with suppliers for both the materials and equipment needed to meet anticipated (or contracted) demand for their firm's output. In the process they will have to exercise unprecedented initiative in creating opportunities for trade.

The exercise of such initiative by enterprises, in both planning and implementation, requires a far more flexible supply and distribution system, one responsive to producers' continually changing needs. Hence the LSE calls for the development of wholesale trade (*optovaia torgovlia*) to facilitate the necessary transactions [Article 15]. By providing relevant, immediate information, wholesale trade should also bolster enterprise autonomy. Moreover, if these markets are to work, the Law recognizes the need for greater price flexibility. To this end, sellers are to negotiate with buyers, subject to centrally determined rules and limitations [Article

17]. Indeed, as the Law intimates, this creation of an operative "socialist market" is a prerequisite for success.

The enterprise's independence and initiative are also sought in the area of investment [Articles 11, 12, 13]. Under the new economic mechanism the central authorities are no longer in a position to determine which investments should be made. Only the firms themselves will have sufficient, detailed information to plan this activity. Thus, aside from major projects, about which the central authorities (e.g., GOSPLAN, GOSKOMTEKHNIKA) can be presumed better informed, the bulk of investment is to be decided by the primary producers themselves, who must negotiate plant modernization and expansion, as well as supplies. Again, the physical means for realizing investment plans are to be acquired through "socialist markets" without direct instruction, allocation, or much interference by the central authorities, save for state orders and ceilings. No longer, as at present, will almost all investment be controlled by authorities above the firm, who assign inputs and contracting organizations.

For autonomy to be meaningful, as the Law recognizes, the firm must be protected from bureaucratic harassment [Article 24]. Ministries are specifically enjoined from interfering in the decision-making process, though, paradoxically, they are also still held responsible for much that their enterprises do [Articles 9, 17, and 18]. Further, the Law envisions a redefined role for most central economic organs, including GOSPLAN, GOSSNAB, GOSKOMTEKHNIKA, and GOSKOMTSEN, sharply reducing their ability to reallocate goods and money.[3] Hence, there will be a distinct reduction in the size and power of these organizations, all in order to alter the relationship between the bureaucracy and the enterprises. An unbreachable legal wall will be in place between them, eliminating the legal responsibility of either one for the actions or obligations of the other [Article 2.6].

With autonomy, however, come provisions guarding against its abuse. Here is where full financial accountability, self-financing, and self-management play a major role. The Law gives the enterprise a virtual "property right" to the residual income that it earns, including far greater discretion over the use of this money. In particular, how income is to be allocated to reward workers and management is left to the labor collective. So is the decision on how to use funds earmarked by central planners (through economic normatives) for investment, research and product/technology development, and for social infrastructure and support [Articles 2, 4, 7, 17]. The assumption is that the firm, in exploiting its autonomy, will use these funds in ways increasing the welfare of its employees, and enhancing its productive capabilities in the hope of producing still greater earnings in the future.

There is also a new negative incentive: No longer will there be any guarantee of support from the state to maintain incomes or to develop production capabilities. Failure will not be excused. Full financial accountability is meant to insure that the enterprise truly earns the monies it disposes of, and that it truly retains control of its legal share of those earnings.

For such financial incentives to become effective, there must also be a thorough revamping of the monetary, banking, and credit systems. Money should be as desirable as any commodity. Banks must become commercial partners, not merely auditors. Credit should become an instrument for supporting economically rational initiatives, while restraining uneconomic activities. Toward these ends the intention of serious reform of the banking and financial systems was announced, with early, albeit disappointing, steps taken in the July 17, 1987, decrees. Further, for money and financial instruments to work, prices must reflect at least approximately true economic value. Thus a price reform was announced [Basic Provisions, Section II], aimed at allowing economic (supply and demand) pressures greater influence over the prices at which transactions take place. It is to be implemented by the beginning of the 13th Five Year Plan in 1991.

Finally, the LSE incorporated a new conception of central economic control [Articles 9 and 10], substituting indirect economic levers for the command mechanisms of the past. These include economic normatives, centrally set prices, rules regulating decentralized (usually contract) prices, credit allocation and the rules governing it, and technological policy implemented through state investments and special interbranch science and technology organs (MNTK's). The new indirect controls are designed to coax enterprises to use their new autonomy in ways furthering centrally planned objectives. They are also to be set so that desirable technologies, products and activities are profitable, while undesired activities, obsolescent technologies, and unnecessary investments are not.

The purpose of these instruments is clear. Through economic normatives, superior authorities will allocate the firm's earnings among personal income, collective consumption, investment, the provision of services and infrastructure, and support for the activities of the central and local governments. Flexible prices are to approximate true values and to adjust in response to economic pressures and to changes in social preferences. Credit is to be used to cover temporary cash flow problems as well as to exploit production and investment opportunities, but not to cover cost overruns and errors in judgment. Finally, new technologies are to be developed under central tutelage and made widely available to all potential producers and users. Through such indirect instruments, Soviet officials aim to improve the quality of central control. Greater economic efficiency is to result from the active participation and cooperation of subordinate enterprises which will now find centrally determined objectives to be in their own economic self-interest.

3 These are, respectively, the State Planning Committee, the State Committee for Material and Equipment Supply, the State Committee for Science and Technology, and the State Price Committee. Each title reflects its primary function.

The Law creates still other incentives for the enterprise to behave "properly," that is efficiently pursue central objectives. First, there are measures aimed at enhancing a sense of employee influence. "Democratization," as the process is called, involves the election of some managers and the creation of a workers' council (Council of the Labor Collective) with a greater say in running the affairs of the enterprise [Articles 6 through 9 and 14]. Second, in order to intensify the effect of financial rewards and penalties, where possible, subdivisions of a firm are to be placed on independent cost accounting (*kollektivnyi khoziastvennyi dogovor*) [Article 5]. Like the larger firm of which they are part, these subdivisions or "collectives" will be responsible for their own financing and contracts. This is an attempt to avoid a "free rider" mentality by bringing incentives (and uncertainty) directly to workers in their production units. Further, the Law strives to improve incentives by expanding enterprise control over the use of funds earmarked for social, cultural, educational, and entertainment uses [Article 13]. All of these measures are designed to strengthen an enterprise's interest in maximizing net income and minimizing expenditures. Finally there is provision for direct foreign trade activity [Article 19] and for mergers [Article 21], further strengthening enterprise autonomy.

The Law thus provides for a dramatic increase in the rights and responsibilities of the Soviet state enterprise, as well as a host of guiding instruments that might induce enterprises to use their new powers in the interests of the state and society as interpreted in central plans. The key to its success lies in the consistency of these measures and objectives. Are the indirect controls provided sufficient to attain planners objectives? Do enterprises have sufficient latitude to perform properly?

Enterprise Autonomy and Economic Levers

The linchpin of the new economic mechanism is the autonomous, self supporting, "socially responsible" socialist enterprise, moved by financial considerations to efficiently pursue quality, innovation, technological progress and the true needs of its consumers. Needless to say, this is a tall order, requiring not only proper incentives for the enterprise's management and workers, but also knowledge of what constitutes quality, progress, and innovation. Then, too, the enterprise must have ready access to the materials and services necessary to achieve those goals, as well as the ability to alter its production and trading activities in their pursuit. These four things, motivation, information, material means, and autonomy, comprise the functional prerequisites for the pursuit of economic efficiency and, hence, for its approximate achievement.

While the Law promotes each of these characteristics, it scarcely establishes truly autonomous enterprises interacting in a decentralized market environment. Rather this is an attempt to loosen central control over the flow of economic activity without abandoning the objectives of that control. The central authorities, in principle, will no longer attempt to manipulate the details of enterprise economic activity. Instead, they hope to keep control over the direction of development through better planning and the use of largely indirect inducements. In the process the center will have less need to worry about plan implementation, and more time to concentrate on a strategy of development, on setting goals, and on maintaining their mutual consistency. The logic of the Law would have the central authorities limit the scope of their concerns in order to allow greater latitude for efficient, innovative enterprise behavior. They are to focus on generalized indices and aggregate outcomes, while leaving it to the firm to deal with the details of achieving their general, abstract objectives.[4]

Nonetheless, the central authorities have retained powerful levers to coax enterprises toward "socially correct" decisions. These include the four means of guidance discussed earlier, and the ability to create, merge, split, and dissolve enterprises. All are indirect with respect to the final outcomes of interest to the central authorities, in particular efficiency and innovativeness. With few exceptions, such as state orders, these levers do not compel specific enterprise decisions or actions, but rather attempt to influence them indirectly by altering either incentives or the economic environment.

This creates a potential problem, if the central authorities take seriously the objectives outlined in the Law and embodied in the control figures of the economic plan. In any economic activity, there is necessarily a long and delicate chain of interactions between responses to incentives and the outcomes generated by those responses. What happens depends on the actions and reactions of thousands of other agents in the system as well as innumerable factors independent of agent behavior. The link between intended effect and actual results is at best tenuous, and frequently nonexistent, having been broken by unexpected changes either in the agent's capabilities or in the economic environment. Potent as the regime's instruments are likely to be, if state enterprises do retain the freedoms granted by the Law, specific consequences can only become more uncertain. The central authorities are in for continual and growing, although not always unpleasant, surprises with regard to aggregate measures of economic performance. However, qualitative indices such as productivity growth, efficiency of resource and factor use, and the pursuit of new technology and innovation, promise to be even more disappointing unless such levers as economic normatives, prices, money and credit are properly

4 These abstract indices include GNP, the "price level," unemployment, average productivity growth, the "level" of industrial output, and other typical macroeconomic indicators.

set in terms of the economic values they reflect and remain "correct" despite changes in the economy.

This difficulty is inherent in the "logic of optimization" as it relates to the tasks assigned to the enterprise under the new Law. The enterprise is explicitly enjoined to maximize net revenues after meeting the cost of supplies, contributing to the central and local budgets and its ministry, and paying for credit [Articles 2, 3, and 17]. This effort is subject to a number of physical and financial constraints contained both in state orders and limits and in the economic normatives. The welfare of the enterprise and its workers, today and tomorrow, depends directly on the size of this revenue and on the normatives regulating its allocation among various legitimate uses. Such is the logic of self-financing and full cost-accounting. The ultimate measure of success becomes the firm's final financial result, supposedly reflecting the true social value of its activity. This, indeed, should provide the proper incentive for efficiency if the values reflected in that financial result, and the social tradeoffs implied by the economic normatives, were correct in terms of social objectives and economic constraints.

The incentive to maximize net revenue derives from the worth of earnings to the enterprise, that is, from the desirable uses to which they can be put. But these uses are subject to the influence of normatives dictating the distribution of earnings among the material incentive (bonus), production development (investment), and housing and social measures funds. This only makes sense if the measures of value to which a firm responds are correct in terms of social desirability and economic scarcity. Self-sufficiency (*polnyi khozraschet*) can only work as intended if prices, economic normatives, and money truly reflect available economic opportunities, and change in response to true changes in opportunity costs. Though the correspondence need not, at any moment, be exact, there must be a continual tolerably close approximation, if the decisions of enterprises are to be at all systematically oriented toward efficiency, i.e., related to cost saving, waste reduction, and rational resource use. Otherwise the rational maximizing response of the enterprise to the existing value configuration will be continually to overuse "cheap" resources, to overproduce "expensive" goods and services, to ignore "unprofitable" opportunities, and to exploit those that appear "profitable" according to distorted signals of value. Thus the key to making the LSE — and indeed the whole economic reform — work lies in establishing and maintaining the correct levels of relative prices and economic normatives, and firmly establishing the value of money.

First of all, money must represent a real ability to acquire goods and services. It should be a true medium of exchange and store of value, not merely a unit of account, and thus both necessary and sufficient to consummate an economic transaction. In other words, money must be able to acquire any commodity, and any commodity must be convertible into money for it to become a useful tool in the implementation and regulation of economic activity as conceived in the Law. Otherwise there is little reason for enterprises to strive to earn it. Economic instruments and criteria are profoundly meaningless without a true money in which to communicate and measure them. The existence of such money is, however, only a necessary, not a sufficient, condition for finding and maintaining the appropriate indices of value needed to guide the economic activity of autonomous enterprises.

Equally important, and even more difficult, is the task of maintaining correct values for all goods and services.[5] This involves attaching prices which accurately reflect the marginal tradeoffs that society, through its economic organizations and actors, is willing to make to each economic activity and product.[6] Those prices are the relative values or marginal rates of exchange of all activities, goods and services. They must depend both on the technical characteristics of production possibilities and on the preferences of society and its members. In particular, prices must represent the value society places on the basic factor inputs of land, labor, and capital, and how these interact with technology and with the structure of production to generate final output. In short, correct values are those accurately reflecting relative economic scarcity, balancing both supply (production) and demand (social desirability) considerations.

The need for such prices arises precisely because of their intended use as a guide to enterprise decisions. Prices affect the pattern of input and factor usage, the output assortment, the use and development of technologies, the volume and pattern of investments made, and the nature of contracts sought, arranged, and consummated. Self-financing enterprises will react strongly to prices and their changes, both current and anticipated, in ways that maximize their net earnings and minimize their costs *in those prices*. Thus incorrect relative prices will seriously distort the structure of production and the pattern of product usage. In the absence of administrative restraints and unless changed, distorted prices lead to a growing imbalance of supply and demand for goods, services, and technologies, with attendant increasing disruption of economic life.

This is also true of the valuation of capital and productive capability. Rational investment requires some way to evaluate existing and potential productive operations in terms of their earning potential. Without such, basic resources and the fundamental factors of land, labor, and capital will be systematically misused and wasted by apparently profitable, economizing decisions. Finally these relative valuations must be sufficiently responsive to supply and demand pressures to generate a stabilizing feedback to investment decisions. That is, they must change in response to shortages or surpluses so as to provide an incentive for the reduction of the imbalance, encouraging investment in those areas with insufficient capacity and discouraging it in areas of excess.

5 For the Soviet Union this requires finding some twenty-eight to thirty million prices and activity values.
6 It should be emphasized that all valuations in the real economic world are necessarily at best approximately correct.

Thus the proper functioning of the LSE requires that prices acquire characteristics quite different from those they presently have. They must reflect and respond to changes in economy-wide opportunity costs. This means that they can no longer remain reliable indices of ex-post physical performance, measuring levels and changes in real economic activity, as they currently do. For any measurements must surely be confounded by unpredictable, yet economically necessary, changes in relative prices. Finally, they must reflect the marginal values that balance supply and demand on all markets, and not administrative, economy-wide average "costs," as at present. Indeed, to function properly as allocative and guiding instruments, prices and other valuations of economic activity must lose much of their utility for measurement and aggregation; fluctuating prices will cause a divergence between the real level of an activity and its measured value. Correct prices must arise out of the interaction of economic agents pursuing value and welfare maximization. Hence, if they are truly to reflect social values, *prices cannot be set.* Attempting to do so prevents their attaining and maintaining the appropriate relative levels.

Similarly, economic normatives must find, and remain at, levels approximately reflecting the relative social desirability of the end uses to which they assign and constrain funds. The portion of earnings assigned to each specific use should reflect the continually shifting pattern of rational usage of those earnings, the appearance of opportunities, and the change in their patterns, for welfare and productivity enhancing expenditures. To stimulate efficient behavior by enterprises, economic normatives should allocate enterprise earnings to those areas, both internal (e.g., investment) and external (e.g., support of local government), with the greatest ultimate social value. This involves maintaining, to the extent possible, an equal incremental return in terms of social welfare across all expenditure categories. This best use of available earnings, and indeed borrowings, in a living, changing economy can rarely be foretold or determined in advance, yet that is precisely what long-term, stable economic normatives pretend to do. To the extent that these normatives fail to take into account the shifting patterns of the rational use of earnings, they will encourage profit-maximizing enterprises to overspend funds in categories with excessive allocations (in terms of their contributions to social objectives) and to underdevelop areas that have received an insufficient allocation.

From this perspective, the enterprise Law clearly fails to establish sufficient economic freedom for the firm. The prices and normatives that enterprises face are not likely to bear any systematic relation to true social values or scarcities. Many prices are still to be administratively fixed; others are to be negotiated between buyer and seller subject to fixed pricing rules; and all are still subject to auditing and the enforcement of price discipline with respect to numerous centrally established criteria [Article 17 and the July 17 decree]. Moreover, prices are to be subject to arbitrary surcharges and discounts based on criteria of engineering, rather than economic, quality — criteria that are to be enforced by third parties (e.g., *Gospriemka* and GOSKOMTSEN).[7] All of this deprives prices of the necessary flexibility and enterprises of the necessary discretion to respond to opportunity costs, to take economically rational actions, and to establish true relative valuations.

Indeed, the limited discretion that the enterprises are given may make things worse. In negotiating "contract prices" they will strive to strike bargains based on costs largely determined by key fixed prices and arbitrary, administrative charges for land, capital, and labor. Further, the proposed system of wholesale trade will place these negotiations in a bilateral monopoly framework as trading partners will be stuck with each other rather than being able to turn to a general market. This will limit the opportunities of the bargainers, thus preventing consideration of economy-wide opportunity costs and allowing very different bargains to be struck in essentially identical economic situations. For example, the same complex equipment might be sold by different producers for different prices to different customers for essentially the same use. While there is some choice of partner in trade, that choice is supposed to yield a long term relation that cannot be easily changed [Article 17 and the July 17 decrees]. Hence, these interactions will become segmented, preventing the spread of useful information through price fluctuations.

Another serious obstacle to rational pricing is the total absence of anything resembling a capital market. Thus there is no way to evaluate properly the factor input whose value fluctuates most extensively, not withstanding the firm's limited ability to trade or lease "excess" capital goods. Rather there are arbitrary administrative charges placed on capital stock, evaluated at the initial expenditure required to build it, that have absolutely no relation to the true (opportunity) cost of those assets or to their potential contribution to enterprise earnings. Finally, even the initial costs of investment are distorted by the proposed system of credit at administered rates and the arbitrariness of allocations to internal investment funds through economic normatives [Articles 17 and 18, and the July 17 decrees]. Thus even where enterprises can take actions influencing prices and costs, there is little reason to expect their actions to facilitate the establishment of economically rational valuations.

This problem with prices disrupts the functioning of three of the prerequisites for the proper operation of the economic reform. Most directly, it means that enterprises will systematically lack reliable information on relative scarcities and use values that is necessary for "economizing" decisions or for pursuing any objective efficiently. This means that the financial incentives facing firms will be distorted, generating actions obviously undesirable from the central perspective.

7 Engineering criteria are physical, measureable standards based on technical data. They bear no necessary relation to, though they may be correlated with, economic criteria.

For example, producers may conserve, at considerable cost, on the use of abundant, but overpriced, inputs, while squandering truly scarce resources that have been undervalued. Prices unrelated to true economic scarcity will lead to choices creating a growing imbalance between supplies and demands and disrupting the functioning of wholesale trade. Thus, the prerequisite of reliable access to supplies and other means of production cannot hold true. Further, the firm's ability to alter its own activities and interactions is still restricted by its founding charter. Hence, the firm has only a limited right to diversify or to abandon insufficiently profitable lines of activity [Articles 1, 2, 4, and 21]. Suppliers can only be changed with permission of the supply system (the local GOSSNAB organ), and output must meet arbitrary third-party standards, rather than the true needs of users. Finally, the choice of technology is subject to ministerial control [Articles 9 and 11]. These and other restrictions impede the enterprise's response to economic considerations and the efficient pursuit of the regime's goals.

In all likelihood, therefore, the Law will not achieve its objectives. The central authorities will find that they are giving up more than just detailed operational control of the economy as they turn to indirect instruments. Because such instruments will not be based on true economic valuations, they will misinform and mislead firms. What appears desirable and profitable to the enterprise will bear no systematic relation to what is important in the eyes of central authorities. Hence, autonomy will be inadvertently turned toward frustrating central objectives and feathering the enterprise's nest. At the same time the firm will continue to do what is ordered as easily and cheaply as possible. The situation likely to follow is, therefore, inherently unstable. The central authorities stand to lose control over even aggregate economic outcomes and indices, without any accompanying gain in efficiency. This is both due to the intrinsic uncertainty in the use of indirect instruments and because the indicators of value and efficiency to which enterprises react are systematically incorrect, and apt to remain so.

These are only a few of the numerous problems likely to arise during implementation of the Law and its current enabling decrees and instructions. The logic of the reform requires that the process move forward toward increasing decentralization, increasing the autonomy of enterprises and other organizations, so that their interaction might reveal and generate appropriate valuations of their products and activities. When enterprises are free to pursue their own perception of economic opportunity, of value creation, and are free to interact with whom they please at unconstrained prices, then they might be "steered" by the delicate manipulation of economic levers toward the broad objectives of the central authorities. Creating such a situation will involve still further radical reform, and the weathering of significant social and economic disruption, as decision-makers learn to cope with the new situation. That will require, as well as tremendous economic acumen, great political will and resolve.

Implications for the Future

Comprehensive and radical reform has been initiated by the new Law and the Basic Provisions. Its logic is that of economic decentralization aimed at inducing innovation, efficiency, and attention to consumer needs. The overall program makes good, general economic sense, and has elicited much enthusiasm among Western observers. But it carries a number of far reaching implications for the economic system, if it is to be realized. A question remains as to whether the provisions of the LSE and its encompassing reform go far enough to meet the objectives of *perestroika.*

For now, it seems the answer is no. Despite a significant loosening of constraints on enterprises, they are still to pursue centrally defined goals under the watchful eye and ready hand of Moscow. Enterprises are still subordinate, and forced to respond to inappropriate signals and controls. Hence it is likely that they will misuse their new autonomy, frustrating the goals of the leadership.

There are two possible responses to such a situation. First, the reform process could move in ever more radical directions, further reducing the constraints on enterprise autonomy and allowing true market relations to arise. This would involve institutional, indeed political, changes limiting State control. Then the economy could eventually acquire the kinds of qualitative characteristics so eloquently described throughout the Law, along with the modicum of control that indicative planning of the Japanese variety provides. Although possible, this approach is unlikely in view of the major changes it would require. First of all, any radical, economy-wide change of capital, technology, and organizational structure is sure to disrupt the normal flow of economic activity, cutting growth rates significantly. Further, the income distribution will come to be related to wealth creation, rather than social or political "worth," and therefore decidedly less equal. Finally, such a process would require extremely "new thinking" on the part of Gorbachev and the Soviet leadership, going well beyond interpretations of "more socialism."

The more likely response is the one that has followed every reform of a Socialist economy: recentralization and restriction of enterprise autonomy in response to growing problems. The avenues for this are at least as numerous as the remaining economic and planning instruments. Indeed, with only minor change in the letter (if not the spirit) of the Law and other reform measures, they could be used to reimpose the Stalinist system, just as Leonid Brezhnev did in the 1970's.

Each of the guiding levers might become compulsory, reimposing the preceding system of tight centralized management. Indeed, there is some fear that this is already happening due to the large share of production handled through state orders.[8] There are vast responsibilities assigned to central organs which, if exercised, will force the return of the old system. Ministries, for example, are held responsible for satisfaction of demand for their products, for productivity increases, for product quality, product and process innovation in their branch, and for the maintenance of a progressive capital structure. If ministerial responsibility for shortages, inefficiencies and low quality is real, then firms can have no true autonomy. Thus there are numerous ready avenues for the reimposition of detailed control should the Law not work as planned.

We should expect fairly widespread disruption of economic activity as the Law spreads across the Soviet economy. Distortions in the structure of production, the nature and types of contracts signed, the prices agreed to by contracting parties, and the assortment available through wholesale trade should appear immediately, though their impact will be moderated by the transitional dampers of state orders, binding control figures and differentiated normatives, ubiquitous ceilings on allocations and investments, and still fixed and micromanaged prices. Slower to appear — but more damaging — will be the growing imbalance between production capacities and needs as enterprises exercise their new, yet improperly informed, powers.

As transitional controls are removed, the growing disruption and obvious misdirection of effort will call for some response. I see little reason to believe that the response will involve letting prices and resource and product flows change uncontrollably as the system shakes out disproportions and strives for equilibrium. Under the present law and decrees, such a response would be impossible: Enterprises have insufficient authority and autonomy; prices are subject to far too much control. Further, accepting such decentralized "groping" toward rough balance of supplies and demands is tantamount to permitting a serious recession, with a possibly significant drop in the overall level of economic activity. Gorbachev, among others, has said this will never happen.[9] Therefore we should expect the reimposition of specific controls, or a delay in their relaxation, as signs of problems mount during the course of the next several years.

Such, however, does not mean the inevitable end of radical reform. The urge to reform, including the necessity for significant improvement in the quality of economic performance, is strong, and apt to become stronger. And other political and social changes should add to that urgency. Yet, there remains a fundamental contradiction in the conception of the reform, between the control over economic activity that the Party desires and the degree of freedom and spontaneity required for innovation and efficiency. If there is indeed "no alternative" to *perestroika*, as Gorbachev asserts, then the decision must be made to plunge into an abyss of spontaneous, unplanned and unpredictable restructuring from below and bear the temporary costs of economic and social disruption. The image of a smooth, controlled, and equitable transition due to the "advantages of Socialism" is a mirage.

True restructuring, yielding the results that the LSE envisions and the Soviets need, can only be achieved through generally unconstrained markets. Recognizing this, and pursuing its implications, will require still further "new thinking" and greater political resolve. The enterprise Law and statements of the Soviet leadership display the necessary will to push the reform further, but not a full comprehension of the underlying economic constraints. Without such comprehension, *perestroika* is apt to degenerate into further steps on the "treadmill of reform," and truly radical reform will remain an unattainable dream.

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8 G. Popov, *Sovetskaia kultura*, January, 1988.
9 A recent statement was made in an NBC interview broadcast November 30, 1987.